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79-1459

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1979

No.

CHARLES G. RODMAN, as Trustee of the Estate of W. T. Grant Company, Bankrupt, and
MORGAN GUARANTY TRUST COMPANY OF NEW YORK,
Petitioners,

v.

ALTON RINIER, as Agent for Certain Employees of Bankrupt; ANSWERING EMPLOYEES OF BANKRUPT; LOCAL 807-IBT; RETAIL CLERKS INTERNATIONAL ASSOCIATION; and NATIONAL LABOR RELATIONS BOARD,
Respondents.

JOINT APPENDIX TO PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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JOINT APPENDIX

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Note: The appendix material contained in this Joint Appendix is filed on behalf of both petitioner Charles G. Rodman, as Trustee of the Estate of W. T. Grant Company, Bankrupt, and petitioner Morgan Guaranty Trust Company.

APPENDIX I

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of Bridgeport, on the 3rd day of January, one thousand nine hundred and eighty.

Present:

HON. WILLIAM H. TIMBERS

HON. THOMAS J. MESKILL

Circuit Judges

HON. LLOYD F. MACMAHON

United States District Judge

Sitting by Designation

UNITED STATES COURT OF APPEALS
Filed
Jan 03 1980
A. Daniel Fusaro,
Clerk
SECOND CIRCUIT

In re W. T. GRANT COMPANY, *Bankrupt.*
CHARLES G. RODMAN, as Trustee of the Estate of W. T. Grant Company, Bankrupt, and MORGAN GUARANTY TRUST COMPANY OF NEW YORK,

Petitioners-Appellants,

v.

ALTON RINIER, as Agent for Certain Employees of Bankrupt, ANSWERING EMPLOYEES OF BANKRUPT, LOCAL 807-IBT, RETAIL CLERKS INTERNATIONAL ASSOCIATION, NATIONAL LABOR RELATIONS BOARD,

Respondents-Appellees.

Docket Nos. 79-5046 and 79-5047

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is *affirmed* substantially for the reasons set forth in District Judge Duffy's opinion of July 18, 1979 and Bankruptcy Judge Galgay's opinion of June 22, 1978, supplemented by the following statement of ours.

This appeal arises from the severance pay claims of over 32,000 former employees of W. T. Grant Co., which, having filed a Chapter XI petition for an arrangement on October 2, 1975, was adjudicated a bankrupt on April 13, 1976. We find the dispositive questions on appeal to be (1) whether Grant, as debtor-in-possession, rejected the executory contracts of its employees, and (2) whether the severance pay claims arising from those contracts are entitled to first priority as costs and expenses of administration.

We answer the first question in the negative. Under "the decisions in this Circuit . . . an executory contract is binding on the debtor in possession if it receives benefits under it." *In re Unishops, Inc.*, 553 F.2d 305, 309 (2 Cir. 1977) (Medina, J.). Here, Grant received benefits under the contracts by permitting the workers to continue in its employ after it entered Chapter XI. As the district court stated, Grant secured "the services of an experienced Grant personnel during the Chapter XI proceeding. Apparently, had Grant been forced to terminate all its employees upon entering Chapter XI and therefore recruit a new work force, even its short-lived Chapter XI attempt would have been virtually impossible."

The Trustee argues that Grant rejected the executory contracts by posting notices in its stores that it was discontinuing the severance pay benefits. We agree with the

bankruptcy and district courts, however, that only a formal rejection pursuant to § 313(1) of the Bankruptcy Act, 11 U.S.C. § 713(1) (1976), is sufficient to disaffirm an executory contract. *See In re Unishops, Inc., supra,* 553 F.2d at 308.

Turning to the second question before us, we reaffirm and adhere to our decision in *Straus-Duparquet, Inc.* v. *Local Union No. 3 International Brotherhood of Electrical Workers,* 386 F.2d 649 (2 Cir. 1967), and hold that the entire portion of the employees' severance pay claims is entitled to first priority as costs and expenses of administration.

The Trustee argues that severance claims should be given a priority only to the extent benefits were conferred upon Grant during the aborted Chapter XI proceeding. He further argues that severance pay, like wages, is earned from day to day, and that the amount of severance pay increases as the employee's tenure increases. The Trustee therefore asserts that the only portion of the severance pay claim that conferred a benefit upon Grant during the Chapter XI proceeding is that which accrued subsequent to the filing of the Chapter XI petition. Only this portion of the severance claim, the Trustee urges, is entitled to priority.

As the courts below recognized, *Straus-Duparquet* forecloses this argument. There we held that severance pay is not earned from day to day and unlike wages does not accrue. Appellants attempt to distinguish *Straus-Duparquet* on the ground that there the Chapter XI proceeding was successful and that only a small portion of the work force was released. Nowhere in *Straus-Duparquet* did we expressly or inferentially predicate our holding on those facts. Instead, our decision turned on our definition of severance pay as compensation for termination, as opposed to a form of wages that accrues from day to day.

Finally, in the alternative, appellants urge that, if *Straus-Duparquet* is fatal to their claim, we should over-

rule that decision since other courts have declined to follow it. *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1 Cir. 1976); *In re Diamond Reo Trucks, Inc.*, No. 74-1788 B 5 (W.D. Mich. June 19, 1979). Our Court, however, repeatedly has followed *Straus-Duparquet. See, e.g., In re Unishops, Inc., supra; In re Bohack Corp.*, 535 F.2d 1240 (2 Cir. 1975), (memorandum order), *cert. denied*, 425 U.S. 966 (1976). In our opinion the rationale of *Straus-Duparquet*—that severance pay is compensation—is sound. We decline appellants' invitation to overrule *Straus-Duparquet*, which remains the law of this Circuit.

Affirmed.

/s/ William H. Timbers
William H. Timbers

/s/ Thomas J. Meskill
Thomas J. Meskill
Circuit Judges

/s/ Lloyd F. MacMahon
Lloyd F. MacMahon
United States District Judge
Sitting by Designation

APPENDIX II

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re
W. T. GRANT COMPANY,
Bankrupt.

CHARLES G. RODMAN, as Trustee of the Estate of W. T. GRANT COMPANY, Bankrupt, and MORGAN GUARANTY TRUST COMPANY OF NEW YORK,
Appellants,

–against–

ALTON RINIER, as agent for certain employees of Bankrupt, ANSWERING EMPLOYEES OF BANKRUPT, LOCAL 807-IBT, RETAIL CLERKS INTERNATIONAL ASSOCIATION, NATIONAL LABOR RELATIONS BOARD,
Appellees.

UNITED STATES DISTRICT COURT
Filed
Jul 18 1979
12:44 p.m.
S. D. of N. Y.

Bankruptcy No. 75 B 1735 (KTD)
OPINION

APPEARANCES:

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KEVIN THOMAS DUFFY, D.J.:

This is an appeal from an order of the Honorable John J. Galgay, Bankruptcy Judge, entered June 22, 1978, concerning the treatment and disposition of certain claims filed against the bankrupt estate of the W. T. Grant Company [hereinafter referred to as "Grant"]. In particular, the order addresses the claims of former Grant employees who qualified for severance benefits and who continued to work for Grant during its unsuccessful attempt at an arrangement under Chapter XI of the Bankruptcy Act [hereinafter sometimes referred to as the "Act"]. Judge Galgay directed that these claims be treated as a cost and expense of the unsuccessful Chapter XI proceeding and pursuant to Section 64(a)(1) of the Act, entitled to full payment as a first priority. The appellants, Charles G. Rodman as Trustee of Grant's estate [hereinafter referred

to as the "Trustee"], and Morgan Guaranty Trust Company of New York on behalf of itself and as agent for other bank claimants, object to this priority treatment and have filed the instant appeal.

On October 2, 1975, Grant filed a petition for an arrangement under Chapter XI of the Act. Thereafter, by order of the Bankruptcy Court dated April 13, 1976, Grant was adjudicated a bankrupt.

Prior to the Chapter XI proceeding, Grant was the operator and manager of over 1,000 retail outlets. In order to induce individuals to accept employment with Grant, it offered potential employees a wage and compensation package which included the receipt of severance pay benefits. The severance pay benefit plans for Grant employees are set forth in the Grant Store Manual, New York Office Supervisor's Personnel Manual, District Manager's Guide to Termination Policy and Procedure and approximately 53 Collective Bargaining Agreements between Grant and various union representatives. See Trustee's Exhibits 1A, 3, 7 and 12A; Retail Clerks International Association's [hereinafter referred to as "RCIA"] Exhibit A. Despite minor variations the agreements generally provide that a worker who meets a minimum "length of service" requirement (generally one year), is, upon termination, entitled to a severance payment. The precise amount of the payment is determined by the number of years the worker was employed by Grant and his weekly salary at the date of termination. For example, under the typical plan a worker employed for two years would receive one week's pay whereas an employee with five years of service would receive two weeks' pay.

Upon the filing of its petition on October 2, 1975, Grant, pursuant to Section 342 of the Act, became a debtor-in-possession and was expressly authorized to operate and manage its retail outlets. Thereafter, during the unsuccessful Chapter XI proceeding, many of Grant's retail outlets

were liquidated and its employees terminated. Finally, in April 1976, Grant was adjudicated a bankrupt and its remaining retail outlets were liquidated and the balance of its work force terminated. As a result, approximately 32,000 employees who were employed during the aborted Chapter XI proceeding and were eventually terminated have filed claims for severance pay benefits. It has been estimated that these claims when finally computed will be in excess of 11 million dollars.

Section 64 of the Bankruptcy Act dictates that certain debts of a bankrupt shall have priority over other debts. It provides:

> The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration . . . (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding. . . .

The Trustee, in his application for instructions as to the treatment and disposition of claims filed against the bankrupt estate, characterized the claims for severance pay as part of the wages earned by Grant employees.[1] He recommended, therefore, that each severance claim be divided into three categories and paid accordingly. First, that portion of an employee's severance claim which accrued subsequent to the filing of the Chapter XI petition would be fully paid as an expense of administration under Section 64(a)(1) of the Act. Second, that portion of an employee's severance claim which accrued during the three months prior to the filing of the Chapter XI petition, not exceeding $600, would be paid as a secondary priority claim under Section 64(a)(2). The balance of the claim would be treated as a pre-Chapter XI non-priority unsecured wage claim.

The claimants,[2] however, argue that severance pay benefits are not akin to wages but rather are a form of compensation for the termination of the employment relationship. They urge that a claim for severance pay does not lend itself to the type of tortured division the Trustee would subject it to. They conclude, therefore, that those employees who continued to work for Grant during the unsuccessful Chapter XI proceeding are entitled to have their entire severance claim treated as a cost and expense of administration.

Judge Galgay adopted the claimants' reasoning. He found that despite contrary authority in other Circuits, under the clear pronouncements of the Second Circuit severance pay is not earned from day to day and unlike wages does not accrue. Accordingly he found that the severance claims for those individuals who continued to work for Grant during the Chapter XI proceeding were not divisible as suggested by the Trustee and were fully payable as a cost and expense of administration. In addition, Judge Galgay found that although Grant, as debtor-in-possession, had the power to reject the severance provisions as executory contracts, it failed to formally do so and consequently the severance provisions survived the Chapter XI proceeding.

There can be no doubt that in this Circuit severance pay benefits guaranteed under a collective bargaining agreement are not to be construed as wages. Indeed, in *Straus-Duparquet, Inc.* v. *Local Union No. 3 International Brotherhood of Electrical Workers,* 386 F.2d 649 (2d Cir. 1967) this Circuit defined severance benefits as

> a form of compensation for the termination of the employment relation, for reasons other than the displaced employees' misconduct, primarily to alleviate the consequent need for economic readjustment but also to recompense him for certain losses attributable to the dismissal.

Id. at 651. The Court went on to hold that "[s]everance pay is not earned from day to day and does not 'accrue' so that a proportionate part is payable under any circumstances." *Id.* The Court concluded that since severance pay is a form of compensation for termination of the employer-employee relationship, where the termination is an incident of the administration of a bankrupt's estate, the payments are entitled to a priority as an expense of administration. *Id. See also In re Unishops, Inc.*, 553 F.2d 305, 308 n.1 (2d Cir. 1977). Thus, insofar as those employees were entitled to severance pay benefits pursuant to the several collective bargaining agreements involved herein, their severance claims are not divisible as suggested by the Trustee. Consequently, absent a rejection of these executory agreements by the Trustee, these claims for severance pay are entitled to a priority.

The law, however, is somewhat less clear with respect to individual severance pay agreements. In the leading case, *Unishops, supra,* 553 F.2d 305, the Court was presented with a letter agreement between a corporation and one of its executive officers concerning severance pay benefits. After eleven years of service Unishops' Chief Operating Officer was promised by the corporation that upon termination he would be entitled to a $100,000 severance payment. Just eight months after the agreement, in November 1973, Unishops filed a petition for an arrangement under Chapter XI of the Bankruptcy Act. Thereafter, Unishops continued to run its operation as a debtor-in-possession. The individual continued to act as Chief Operating Officer at Unishops until July 1974 when he was discharged.

The Court found that since the officer had continued in Unishops' employ for some time after it entered Chapter XI, and since the debtor-in-possession never rejected the executory severance agreement, Unishops received benefits under the contract and hence he was entitled to a priority

under Section 64(a)(1) of the Act. The confusion arises, however, in a footnote to the Court's decision where it is stated that while those "cases involving severance pay under collective bargaining contracts, such as *Straus-Duparquet, Inc.* v. *Local Union No. 3, supra,* 386 F.2d 649 (2d Cir. 1967), correctly define severance pay as compensation for termination of employment and hence usually an expense of administration, . . . *they are not determinative of the issue before us.*" *Id.* at 308 n.1 (emphasis supplied).

The Trustee urges that the above quoted language indiccates that although severance benefits under a collective bargaining agreement are to be construed as compensation for termination, individual severance pay agreements are not to be so classified. I disagree.

A reading of the *Unishops'* decision indicates that the issue before the Court was not the classification of severance benefits as either wages or termination compensation, but rather whether the debtor-in-possession ever rejected the executory severance as authorized under the Bankruptcy Act. Consequently, the *Straus-Duparquet* doctrine was simply "not determinative" of the issue before the *Unishops'* Court. Nowhere did the Court indicate, as the Trustee suggests, that the *Straus-Duparquet* doctrine was somehow inapplicable. Moreover, there appears to be no sound reason why the doctrine should not apply with equal force to individual severance agreements. Indeed, the nature of severance benefits is not altered simply because entitlement to the benefits originates in an individual employment contract as opposed to a collective bargaining agreement. Suffice it to say that in the case at bar the individual severance agreements were in no sense intended to represent compensation for services rendered or to be rendered by Grant employees. In fact, individual agreements were virtually identical to those contained in the collective bargaining agreements and could only be intended as compensation for termination. Accordingly, those severance

claims arising out of individual employment agreements must stand on the same ground as those emanating from collective bargaining agreements.[3]

This determination, however, does not end our inquiry. It is clear that the Bankruptcy Act permits a debtor-in-possession to reject executory contracts. See, e.g., 11 U.S.C. §§ 313(1), 357(2) and Chapter XI rule 11-53, 415 U.S. 1036 (1974).[4] *See also in re Unishops, supra,* 553 F.2d at 308. However, this Circuit has held that

> [a] debtor in possession . . . may disaffirm or reject an executory agreement *only in accordance with the statutory procedures.* As stated in the leading treatise,
>
> > 'The failure to assume affirmatively an executory contract does not result at any time in a rejection of the contract. Whether the debtor is in possession, or whether there is a receiver or trustee, the contract can be rejected *only by affirmative action under § 313(1) and Chapter XI Rule 11-53 or § 357(2). Unless so rejected, the contract continues in effect.'*

Id. at 308 (emphasis added). Thus, the issue is whether Grant ever rejected the executory severance agreements while it acted as debtor-in-possession.

It is undisputed that Grant did not affirmatively reject the agreements in issue pursuant to the statutory provisions of the Bankruptcy Act. The Trustee argues, however, that a debtor-in-possession is a separate and distinct juridical entity from that of the pre-Chapter XI debtor and as such is not bound by the agreements of the debtor absent an affirmative assumption thereof. He concludes that since Grant made no such affirmation of the severance agreements during the Chapter XI proceeding, it is not bound by the agreements. Alternatively, the Trustee argues that Grant's conduct upon commencement of the Chapter XI proceeding

was sufficient under the circumstances to reject the severance agreements. Finally, the Trustee urges that should the severance claims be deemed as a cost and expense of administration, the amount of each claim must be limited to the actual value of the benefits conferred upon the debtor-in-possession during the Chapter XI proceeding. I find these arguments to be inapposite.

There is no doubt that a debtor-in-possession is deemed to be an entity separate and distinct from the debtor. *See, e.g., Truck Drivers Local No. 807* v. *Bohack Corp.,* 541 F.2d 312 (2d Cir. 1976); *Brotherhood of Railway, etc.* v. *REA Express, Inc.,* 523 F.2d 164 (2d Cir.), *cert. denied,* 423 U.S. 1017, 1073 (1975-76); *Shopman's Local No. 455 etc.* v. *Kevin Steel Products, Inc.,* 519 F.2d 698 (2d Cir. 1975). It is equally settled, however, that a claim arising under an executory contract is entitled to a priority as a cost and expense of administration "if the trustee or debtor in possession elects to assume the contract *or if he receives benefits under it.*" *Unishops, supra,* 553 F.2d at 308 (emphasis added). Consequently, a formal assumption of the contract is unnecessary where the debtor-in-possession reaps the benefits of the contract during a Chapter XI proceeding.

In the instant action, Grant never formally assumed the executory contracts in issue. However, it did permit its employees, covered by the severance agreements, to continue in its employ after it entered Chapter XI. Hence, at the very least Grant received benefits under the executory contracts by virtue of securing the services of experienced Grant personnel during the Chapter XI proceeding. Apparently, had Grant been forced to terminate all its employees upon entering Chapter XI and thereafter recruit a new work force, even its short-lived Chapter XI attempt would have been virtually impossible. Accordingly, in light of these benefits the severance claims of the employees were entitled to a priority as a cost and expense of administration. *Unishops, supra,* 553 F.2d 308. This is true

despite Grant's "good faith attempt to reject the executory contracts formally binding upon the debtor." See Judge Galgay's memorandum opinion at page 5. As Judge Galgay correctly held, only a formal and affirmative rejection pursuant to Sections 313(1), 357(2) of the Bankruptcy Act was sufficient to disaffirm the contracts herein. *Id.* Suffice it to say that Grant's efforts, short of a formal rejection, were insufficient to cause a rejection of the severance agreements herein.[5]

I turn finally to consider whether the Grant employees are entitled to recover 100 percent of their severance awards as a cost and expense of administration. The Trustee argues that since these claims were given priority treatment solely because Grant received benefits under the severance agreements during the Chapter XI proceeding, Judge Galgay erred in permitting 100 percent of each claim to be given a priority. Relying upon *American Anthracite & Bituminous Coal Corp.* v. *Leonardo Arrivabene, S.A.,* 280 F.2d 119 (2d Cir. 1960), the Trustee urges that a severance claim should be given a priority only to the extent benefits were conferred upon Grant during the aborted Chapter XI proceeding. In other words, rather than treating the entire severance claim as computed under the agreement as a cost and expense of administration, only the "reasonable value" of the benefits conferred upon Grant should be granted priority status.

While apparently supporting the Trustee's position, I believe the Second Circuit has recently retreated from that portion of its decision in *American Anthracite* which limits the priority to the reasonable value of the benefits conferred. Indeed, in *Unishops, supra,* the Court held that an employee's severance claim was entitled to be treated, without limitation, as a cost and expense of administration solely because the debtor-in-possession had received the benefits of the employee's services during the Chapter XI proceeding. The Court, while citing *American Anthracite,* made no

attempt to limit the claim to the value of the benefits conferred. Rather, the Court permitted the claimant to recover the full amount of severance pay guaranteed under the severance agreement as a cost and expense of administration. *Unishops, supra,* 553 F.2d at 308. I feel constrained by this later decision and accordingly affirm Judge Galgay's treatment of the severance claims.[6]

Accordingly, Judge Galgay's order is affirmed.

So Ordered.

/s/ Kevin Thomas Duffy
U. S. D. J.

Dated: New York, New York
July 18, 1979

FOOTNOTES

[1] It is important to note from the outset that at no time did an employee's right to severance pay vest prior to termination. Under the express terms of the several severance plans at bar, employees who voluntarily resigned or were terminated *for cause* were not entitled to severance payments. Consequently, the entitlement to severance pay was not finally determined until the day of termination.

[2] The claimants, appellees herein, consist of Alton L. Rinier, as common agent on behalf of former Grant employees, Answering Employees of the Bankrupt, Local 807-IBT, Retail Clerks International Association and the National Labor Relations Board. The sole distinction among these claimants is that while some are governed by the severance provisions contained in the over 53 Collective Bargaining Agreements between Grant and Union representatives (Trustee's Exhibit 7; RCIA's Exhibit A), the remaining non-union employees are governed by the severance provisions contained in the various Grant Store Manuals (Trustee's Exhibits 1A, 3 and 12A).

[3] The Trustee also seeks to avoid the *Straus-Duparquet* doctrine by arguing that it should be limited only to those cases in which a Chapter XI arrangement has been successful. I find this attempted limitation to be totally artificial and without merit.

[4] Section 713 of the Act provides:

> Upon the filing of a petition, the court may, in addition to the jurisdiction, powers, and duties conferred and imposed upon it by this chapter—
>
> (1) permit the rejection of executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate;

Section 757 of the Act goes on to provide:

> An arrangement within the meaning of this chapter may include—
>
> (1) provisions for treatment of unsecured debts on a parity one with the other, or for the division of such debts into classes and the treatment thereof in different ways or upon different terms;
>
> * * *

[5] *See also* In re Alfar Dairy, Inc., 458 F.2d 1258 (5th Cir.), *cert. denied*, 409 U.S. 1048 (1972). In *Alfar* the Court held that the Bankruptcy Act does not permit a "tacit" rejection of an executory contract. *Id.* at 1260. Consequently, "even though a party to an executory contract . . . may know by one means or another that the

bankrupt does not intend to perform, the contract is not voided as a result of this knowledge but remains in force until rejected pursuant to the Act." *Id.* at 1261.

[6] This result fully comports with this Circuit's decision in *Straus-Duparquet* holding that since severance pay is a form of compensation for termination of the employment relation rather than something that is earned from day to day, it is not capable of apportionment and the full severance award is payable upon termination. 386 F.2d at 651.

APPENDIX III

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter — of — W. T. GRANT COMPANY *Bankrupt.*	No. 75 B 1735 MEMORANDUM OPINION

JOHN J. GALGAY—*Bankruptcy Judge*

The trustee for the bankrupt estate of W.T. Grant Company has applied to this Court for instructions as to the treatment and disposition of claims filed against the bankrupt estate by former employees of Grant for severance pay benefits. The claims arose as a result of the petition filed by W.T. Grant Company on October 2, 1975 for an arrangement under Chapter XI, Sec. 322 of the Bankruptcy Act, 11 U.S.C. Sec. 722. Despite attempts to rehabilitate the operations and management of the retail chain, the company was adjudged a bankrupt by this court on April 13, 1976, compelling the liquidation of all retail outfits as well as the termination of employment of approximately 75,000 individuals.

Prior to the filing of the Chapter XI petition, Grant provided employees with a wage and compensation package which included the prospect of receiving severance pay benefits in the event of dismissal, dependent upon length of service with the company. As an employee's term of employment increased, the amount of his potential severance pay benefits for dismissal also increased. Subsequent to the filing of the Chapter XI petition, Grant as debtor-in-possession, notified its employees that severance pay benefits would be discontinued pending the development of a payment plan subject to the approval of this court. A total of 41,000 proofs of claim seeking severance pay benefits in

excess of $20,000,000 were eventually filed by employees against the bankrupt estate.

The issue raised in this proceeding questions whether severance pay benefits owed by the debtor-in-possession to employees who performed services for the bankrupt prior to the filing of the petition are to be treated as costs and expenses of administration which are entitled to full payment in an unlimited amount under Sec. 64(a)(1) of the Bankruptcy Act, 11 U.S.C. 104(a)(1).

The trustee characterizes the claims for severance pay benefits as part of the wages earned by each eligible employee during the course of his employment, with the right to and the amount of such benefits dependent upon the period of employment. Consequently, the trustee recommends that the claims be awarded on a pro-rata basis through the use of a per diem value established for the year preceding the termination of the particular employee. Accordingly, the portion of severance pay which has accrued subsequent to the filing of the Chapter XI petition would be paid as an expense of administration under Sec. 64(a)(1) of the Bankruptcy Act. The portion which had accrued in the three months prior to the filing of the Chapter XI petition not in excess of $600, would be paid as a second priority claim under Sec. 64(a)(2). The balance of the claim would be treated as a pre-Chapter XI non-priority unsecured wage claim. The trustee argues that the proposal fully conforms with the provisions of the Bankruptcy Act, provides fair and equitable treatment of all former employees and protects the interests of the other creditors of the bankrupt estate.

The case law governing the matter in question is beset by a sharp conflict between the circuits. Two circuits have held that only that portion of the severance pay claim which can be allocated to services performed by employees after the filing of the arrangement is entitled to first priority, *In*

re Mammoth Mart, Inc. 536 F.2d 950 (1st Cir. 1976); *In re Public Ledger* 161 F.2d 762 (3d Cir. 1947), whereas our circuit (the 2nd Circuit) has held that the entire amount of such a claim should be afforded Sec. 64(a)(1) treatment, *In re Straus-Duparquet, Inc.* 386 F.2d 649 (2d Cir. 1967). The trustee urges this court to embrace the law in the First and Third Circuits as an alternative to the position adopted by the Second Circuit in *In re Straus-Duparquet,* supra and its progeny.

The trustee argues that severance pay benefits owed by the debtor-in-possession to employees who performed services for the bankrupt prior to the commencement of the Chapter XI are not costs and expenses of administration entitled to full payment in an unlimited amount. This position is premised upon the fact that W.T. Grant Company, as debtor-in-possession under Chapter XI, became a new entity "with its own rights and duties, subject to the supervision of the Bankruptcy Court." *Shopmen's Local Union No. 455* v. *Kevin Steel Products, Inc.* 519 F.2d 698 (2d Cir. 1975); *Brotherhood of Railway Express* v. *REA Express, Inc.* 523 F.2d 164 (2d Cir. 1975), *cert. denied* 423 US 1017 (1976). See also *Allegaert* v. *Perot* 548 F.2d 432 (2d Cir. 1977). Thus, we must consider the legal rights of two separate and distinct juridical entities: the pre-petition debtor and the post-petition debtor-in-possession.

The fundamental role of the debtor-in-possession is rehabilitation of the financially troubled business. In furtherance of that goal, the debtor-in-possession is free to terminate unprofitable activities and reject burdensome executory contracts, see 11 U.S.C. Sec. 731(1). The Second Circuit has previously recognized that "(t)he claims of a creditor having an executory contract with the debtor at the time the debtor's petition is filed is entitled to priority under these provisions only if the trustee or debtor-in-possession elects to assume the contract or if he receives benefits under it." *American Anthracite & Bituminous Coal*

Corp. v. *Leonardo Arrivabene S.A., et al.* 280 F.2d 119 (2d Cir. 1960).

The trustee asserts that the executory wage contracts between the employees and the Grant Company were not adopted or assumed by the debtor-in-possession. The store closing manual prepared by the debtor-in-possession specifically stated in reference to termination pay that the company was developing a plan for the payment of termination or incentive pay in connection with store closings, which would be subject to the approval of the Bankruptcy Court. Furthermore, the debtor-in-possession distributed a notice posted in all stores which informed all employees of the policy to discontinue the payment of severance pay, pending an order of the Bankruptcy Court.

The evidence introduced by the debtor-in-possession clearly indicates a good faith attempt to reject the executory contracts formerly binding upon the debtor. However, the fact remains that the debtor-in-possession never did follow the formal rejection proceedings outlined in the Bankruptcy Act. This hybrid action can be contrasted with the steps taken by the debtor-in-possession in the *REA* bankruptcy to affirmatively reject the collective bargaining agreements binding upon the debtor.

The trustee rests his proposal for allocating severance pay upon the fact that the debtor-in-possession received benefits under the contract during the Chapter XI proceeding. The trustee asserts that the claims for severance pay benefits may be entitled to priority as costs and expenses of administration to the extent that the consideration supporting the claims was supplied during the reorganization: See *In re Mammoth Mart, Inc.*, supra. The First Circuit found in *Mammoth Mart* that the services performed for the debtor over the entire period of each claimant's employment constituted the consideration for the claims made. Since no part of the claims arose from services performed for *Mammoth Mart* as debtor-in-possession, no portion of the claims secured Sec. 64(a)(1) priority.

Similarly, in the case at hand, the amount of severance pay claims depends upon the length of employment and all of the services performed for W. T. Grant Company constitute consideration for the severance pay claims made. Consequently, the trustee proposes to allocate, as a first priority, the reasonable value of the benefits conferred upon the debtor-in-possession by each claimant.

The trustee asserts finally, that his proposal best satisfies the equitable principles governing the Bankruptcy Act. The Supreme Court stated that "(i)f one claimant is to be preferred over others, the purpose should be clear from the statute". *Nathanson* v. *NLRB* 344 U.S. 25, 29 (1952). The Trustee has questioned the statutory basis for affording the entire amount of a severance pay claim first priority treatment in light of the careful consideration Congress gave to the allocation of employee claims under Sec. 64(a)(2). The Trustee argues that his proposal best maintains the desired consistency between Sec. 64(a)(1) and 64(a)(2) of the Bankruptcy Act.

The former employees of Grant vigorously object to the trustee's proposal. The employees assert that payment of severance pay was fixed by rules and regulations of the Company which remained in force after the filing of the petition and are binding upon the debtor-in-possession. The applicable law recognizes severance pay as damages payable for termination of employment. Since termination occurred during a Chapter XI proceeding, the full amount of severance pay is owed by the debtor-in-possession as an expense of administration. The employees rely upon the controlling principles in *In re Straus-Duparquet, Inc.* 386 F.2d 649 (2d Cir. 1967) and its progeny, *In re Bohack* 535 F.2d 1240 (2d Cir. 1975) and *In re Unishops, Inc.*, 553 F.2d 305 (2d Cir. 1977).

The Court held in *Straus-Duparquet,* that "(s)everance pay is not earned from day to day and does not accrue so that a proportionate part is payable under any circumstances. After the period of eligibility is served, the full severance pay is due whenever termination of employment occurs." 386 F.2d 651. The former employees closely link the facts at hand to those in *Straus-Duparquet* and argue that since employment was terminated as an incident of the administration of the bankrupt's estate, severance pay is an expense of administration and is entitled to priority treatment.

Although this Court finds the logic of the First Circuit in *Mammoth Mart,* supra, appealing and the holding most consistent with the equitable principles in the Bankruptcy Act, we are bound by the controlling authority in the Second Circuit and therefore must apply the rationale of *Straus-Duparquet,* supra, to the matter in question. Circuit Judge Friendly aptly phrased this principle in his concurring opinion in *United States* v. *A Motion Picture Entitled "I am Curious Yellow"* 404 F.2d 196, 200 (2d Cir. 1968) where he stated; "our duty as an inferior federal court is to apply as best we can, the standards" of our superior courts.

Furthermore, the trustee's attempts to distinguish our facts from those in *Straus-Duparquet,* supra, and to align our issues more closely with *In re Mammoth Mart,* supra, lack sufficient merit. The First Circuit rejected a factual distinction between the two cases when it stated in *Mammoth Mart* that "implicit in the foregoing discussion, we find the reasoning in support of the contrary result in *Straus-Duparquet* . . . unpersuasive. There *(Straus-Duparquet)* the court concluded that severance pay claims similar to appellants' were entitled to first priority . . ." 536 F.2d at 955.

The fact that we are dealing primarily with non-union employment contracts instead of with a full scale union collective bargaining agreement or with an unsuccessful

Chapter XI proceeding instead of with a successful arrangement, are factors which a higher court may employ to further narrow the breadth of *Straus-Duparquet.* The Second Circuit first clarified the doctrine in *In re Unishops,* supra, footnote 1 (one) where it states that "(t)he cases involving severance pay under collective bargaining contracts, such as *Straus-Duparquet* correctly define severance pay as compensation for termination of employment and hence *usually* an expenses of administration, but they are not determinative of the issue before us." The court evidently has recognized that the facts and the equitable interests in particular situations do not require first priority treatment of severance pay claims. Further guidance however, is needed in this area.

In light of the foregoing findings of fact and conclusions of law, this court feels compelled to follow the direction of the Second Circuit and instructs the trustee to compute severance pay for each former employee of Grant discharged during the Chapter XI proceeding and to pay it in full as an expense of administration under Sec. 64(a)(1) of the Bankruptcy Act, 11 U.S.C. Sec. 104(a)(1).

Settle order in conformity with the foregoing.

Dated: New York, New York
June 22, 1978

/s/ JOHN J. GALGAY
Bankruptcy Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re W. T. GRANT COMPANY, *Bankrupt.*	Bankruptcy No. 75 B 1735

ORDER AUTHORIZING AND APPROVING PAYMENT OF SEVERANCE PAY BENEFITS

Upon the application of Charles G. Rodman, as Trustee of the Estate of W. T. Grant Company, Bankrupt (the "Trustee"), dated May 10, 1977, for instructions as to the disposition of claims made by former employees of W. T. Grant Company ("Grant"), other than former officers and directors, for vacation and severance pay benefits, the hearing held on June 28, 1977 to consider said application at which the appearances of interested parties were noted in the record, the objections interposed to the Trustee's recommendations and upon all of the proceedings had before the court, the decision and order dated June 7, 1978, directing the disposition and satisfaction of claims for vacation pay benefits, and the court having filed its written opinion dated June 22, 1978, as to the disposition and satisfaction of claims for severance pay benefits, and sufficient cause appearing therefor, it is

ORDERED that the portion of proofs of claim filed with the court by former employees of Grant who were discharged during the aborted Chapter XI case for severance pay benefits, other than former officers and directors, to the extent that the Trustee is hereafter authorized and directed by order of the court to make distributions from the assets of the bankrupt estate to satisfy such claims, upon the authority of *In re Straus-Duparquet, Inc.*, 386 F.2d 649 (2d Cir. 1967) and *In re Unishops, Inc.*, 553 F.2d 305 (2d Cir. 1977), be, and they hereby are, claims entitled to priority as costs and expenses of administration of the

aborted Chapter XI case under Section 64a(1) of the Bankruptcy Act, 11 U.S.C. § 104a(1), entitled to priority after the payment of the costs and expenses of the bankruptcy case under Chapters I-VII of the Bankruptcy Act; and it is further

ORDERED that the gross amount of such claims of former employees for severance pay benefits are to be calculated in accordance with the policies, procedures and practice of Grant or, where appropriate, its collective bargaining agreements, in effect or enforceable in respect of such benefits as of October 1, 1975 as described during the hearing held on June 28, 1977 and incorporated in the record of that hearing.

Dated: New York, New York
July 21, 1978

/s/ JOHN J. GALGAY
Bankruptcy Judge

APPENDIX IV

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

Filed
Jan 21 1980
Richard H. Deane
Clerk,
U.S. Court of Appeals

LOCAL JOINT EXECUTIVE BOARD, AFL-CIO, et al.,
Plaintiff-Appellant,

vs.

HOTEL CIRCLE, INC., et al.,
Defendant-Appellee.

No. 76-3066
OPINION

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA

Before: WRIGHT, WALLACE, and ANDERSON, *Circuit Judges*

WALLACE, *Circuit Judge:*

This appeal requires us to address tensions between the language and underlying policies of the Bankruptcy Act and the National Labor Relations Act (NLRA). The district court upheld the decision of the bankruptcy judge relieving Hotel Circle, Inc. (Hotel Circle) from the obligations of a collective bargaining agreement with Local Joint Executive Board, AFL-CIO (Union). *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc.*, 419 F. Supp. 778 (S.D. Cal. 1976). The Union alleges that the district court erred in defining the scope of section 313(1) of the Bankruptcy Act, 11 U.S.C. § 713(1), which allows the bankruptcy court to permit rejection of executory contracts of the debtor, and erred in holding that a bankruptcy receiver lacks authority to assume unilaterally or enter into long-term collective bargaining agreements. We affirm.

I

On October 10, 1974, Hotel Circle filed for protection under Chapter XI of the Bankruptcy Act, 11 U.S.C. §§ 701

et seq. After the Chapter XI petition was filed, the business was operated by the debtor in possession until a receiver was appointed on July 21, 1975. During this time, Hotel Circle continued to operate under a 1973 collective bargaining agreement between it and the Union, which was scheduled to expire in 1977. Hotel Circle was a member of the Restaurant-Hotel Employers' Council (Council), the multi-employer group which had negotiated the 1973 agreement. After its appointment, the receiver sent a representative to participate in discussions between the Council and the Union on the subject of modifying and extending the agreement. On August 18, 1975, the receiver's representative was among those who voted to accept a proposed wage increase and to extend the life of the existing agreement. Although not expressly indicating that he was bound by the renegotiated contract, the receiver paid the hotel's employees in accordance with the higher wage scale of the new agreement.

In the meantime, the receiver negotiated a proposed sale of the Le Baron Hotel, which sale was conditioned on the purchaser taking clear of any existing collective bargaining agreement. In December 1975 the receiver applied for an order authorizing sale of the hotel, and the Official Creditors' committee filed a motion seeking to reject various executory contracts, including the collective bargaining agreement between the Council and the Union. On December 15, 1975, the bankruptcy court authorized the sale of the hotel, and on January 6, 1976, the court issued an order rejecting the collective bargaining agreement.

The Union contends that the district court erred on several grounds in sustaining the decision of the bankruptcy judge allowing rejection of the agreement. First, it contends that the rejection provision of Chapter XI of the Bankruptcy Act, section 313(1), 11 U.S.C. § 713(1), should properly be read as excluding collective bargaining agreements because of their unique nature and the policies underlying the labor laws. Second, assuming the bankruptcy court may allow rejection of a collective bargaining agreement, the Union contends that the receiver had authority to affirm the agreement, thereby binding the estate, and did in fact affirm it by entering into negotiations for its modification and extension and by adopting its terms. The Union claims that the district court erroneously decided this issue because it improperly concluded that a receiver is not an "employer" under the NLRA. Finally, the Union contends that the receiver had authority to, and did in fact, enter into the modified agreement, arguing that this authority stemmed from his order of appointment from the bankruptcy court as well as from his duty to bargain under the NLRA. It also argues that the rejection provision relied on by the bankruptcy court to "reject" the modified agreement does not apply to contracts of the receiver. These contentions will be dealt with in turn.

II

We have never confronted the question whether section 313(1) of the Bankruptcy Act, 11 U.S.C. § 713(1), allowing the rejection of executory contracts of the debtor, applies to collective bargaining agreements. Acknowledging that the weight of authority is to the contrary, the Union urges us to find that such an agreement is not an "executory contract" for purposes of section 313(1).[1] The Union encourages us to construe the language of the Bankruptcy Act so that it would be consistent with the apparently absolute language of section 8(d) of the NLRA, 29 U.S.C. § 158(d), which requires certain procedures and conditions for the termination or modification of a collective bargaining agreement.

The NLRA should govern, according to the Union, because labor agreements are not ordinary executory contracts, but rather generalized codes for industrial peace. *John Wiley & Sons, Inc.* v. *Livingston,* 376 U.S. 543, 550

(1964); *United Steelworkers* v. *Warrior & Gulf Navigation Co.*, 363 U.S. 574, 578-80 (1960). The Union argues that the labor law policy of promoting industrial peace and stability for employees, *John Wiley & Sons, Inc.* v. *Livingston, supra,* 376 U.S. at 549, suggests that Congress did not intend to include labor agreements among the "executory contracts" that could be rejected under the Bankruptcy Act. It contends that this interpretation is further bolstered by the inadequacy of the Bankruptcy Act's remedy of actual damages for rejected contracts. Since many of the benefits of labor agreements are intangible, such agreements do not, according to this argument, lend themselves to damage measurement as would a commercial agreement.

These and other arguments were recently considered by the Second Circuit in *Shopmen's Local 455* v. *Kevin Steel Products, Inc.*, 519 F.2d 698 (2d Cir. 1975). That court held, consistent with prior district court cases, that section 313(1) applies to labor agreements. *See, e.g., Carpenter's Local 2746* v. *Turney Wood Products, Inc.*, 289 F. Supp. 143, 147-50 (W.D. Ark. 1968); *In re Overseas National Airways, Inc.*, 238 F. Supp. 359, 361 (E.D.N.Y. 1965); *In re Klaber Bros., Inc.* 173 F. Supp. 83, 85 (S.D.N.Y. 1959). The court in *Kevin Steel* relied in part on the unqualified statutory language of the Bankruptcy Act and on the fact that Congress had previously demonstrated its ability to carve labor agreements out of a general grant of power to reject executory contracts. 519 F.2d at 701-02. *See* Bankruptcy Act § 77(n), 11 U.S.C. § 205(n) (prohibiting bankruptcy court or trustees from changing wages or working conditions of railroad employees except in manner prescribed by Railway Labor Act). At the same time, the court acknowledged that "the issue is not a simple one to be decided only by a literal reading of section 313(1)." *Id.* at 703. Therefore, the Second Circuit examined the policies of the acts in question and determined, correctly we think, that the Bankruptcy Act's provisions were intended to prevail. The court stated that a debtor in possession or receiver under Chapter XI of the Bankruptcy Act is, in a real sense, not the same entity as the pre-bankruptcy company. It is "[a] new entity . . . with its own rights and duties, subject to the supervision of the bankruptcy court." *Id.* at 704. The court concluded that this new entity is not a "party" to the existing labor agreement for purposes of the section 8(d) termination restrictions, reasoning that to require the debtor-in-possession or receiver to assume an outstanding labor contract would place the new entity "in a worse position than a successor employer, who is generally not bound by the existing labor agreement. *See NLRB* v. *Burns Int'l Security Services, Inc.*, 406 U.S. 272, 281-91 (1972)." *Id.*[2]

We recognize, on the one hand, that this analysis is not inexorable and is based on a policy choice which emphasizes the changed status of the debtor in bankruptcy for purposes of analyzing its obligation under 8(d). The Second Circuit has acknowledged that *Kevin Steel* analogized the position of a receiver in bankruptcy to that of a successor employer, and thus reasoned that a receiver is not a "party" to the labor agreement, "for the narrow purpose of resolving otherwise conflicting provisions of the labor laws." *Truck Drivers Local 807* v. *Bohack Corp.*, 541 F.2d 312, 320 (2d Cir. 1976). On the other hand, we are convinced that the analogy to successorship cases in this limited area is valuable, and we agree that it would be anomalous to bind the receiver in reorganization proceedings when a successor employer is not bound. *See NLRB* v. *Burns Int'l Security Services, Inc., supra,* 406 U.S. at 287-88 (refusing to impose a labor agreement on successor employer in part bacause to do so might discourage needed transfers of capital). The policy of allowing a new start to a debtor in reorganization proceedings provides an even stronger reason for not automatically imposing the existing labor agreement than does the policy recognized in *Burns* of encouraging the flow of capital.

It is significant that in *Burns* the Supreme Court rejected the argument, analogously made here, that the unique nature of labor agreements and the policy of promoting stability for employees should overcome the corresponding rights and interests of a successor employer. The Court stressed that the cases relied on by the union there involved suits to compel arbitration and reflected " 'the preference of national labor policy for arbitration as a substitute for tests of strength between contending forces.' " *NLRB* v. *Burns Int'l Security Services, Inc., supra,* 406 U.S. at 286 (quoting *John Wiley & Sons, Inc.* v. *Livingston, supra,* 376 U.S. at 549).

Similarly, we conclude that the unique features of labor agreements do not overcome the plain language of the Bankruptcy Act and the policies embodied in Chapter XI proceedings. While we recognize that important employee interests are at stake when rejection of a labor agreement is considered, the policies of the Bankruptcy Act are designed to assist failing businesses, a goal in which employees ultimately have a stake as well. We do not believe that the power to reject labor agreements found to be onerous and burdensome to the debtor's estate is inconsistent with the policies of the labor laws.[3]

III

We now consider the contention that the receiver prevented the subsequent rejection of the collective bargaining agreement when he affirmed the contract and thereby bound the estate. First, we put to one side a sub-issue which we do not believe is dispositive of the main question. The Union contends that the district court failed to confront the tension between the NLRA and the Bankruptcy Act on this question because it misconstrued the status of a receiver under the labor laws. Relying on the *Kevin Steel* conclusion that a receiver is a new entity which is not a "party" to a labor agreement for section 8(d) purposes, the district court went

on to conclude that "[t]he bankruptcy entity is not an employer within the meaning of the National Labor Relations Act unless the entity becomes a party to the collective bargaining agreement." *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 785. The Union points to cases holding that receivers are employers under the labor laws and, as such, are liable for unfair labor practices and are obligated to bargain under the Act. *In re American Buslines,* 151 F. Supp. 877, 882 (D. Neb. 1957); *NLRB* v. *Baldwin Locomotives Works,* 128 F.2d 39, 43 (3d Cir. 1942); *NLRB* v. *Bachelder,* 120 F.2d 574, 576 (7th Cir.), *cert. denied,* 314 U.S. 647 (1941). As the Union observes, *Kevin Steel* also recognized that the new entity of a bankruptcy reorganization proceeding must comply generally with the NLRA. *Shopmen's Local 455* v. *Kevin Steel Products, Inc., supra,* 519 F.2d at 704.

While we agree that a receiver has the general duty to bargain and otherwise comply with the NLRA, we are not persuaded that the receiver's status as an employer is dispositive of the issue as to his authority to adopt a collective bargaining agreement. The receiver's duty to bargain does not imply that he possesses all of the power and responsibilities of a regular employer. Nor does it change the fact that he is an officer of the bankruptcy court possessing limited, strictly construed authority. *See, e.g., Chicago Deposit Vault Co.* v. *McNulta,* 153 U.S. 554, 561 (1894). Therefore, the fact that he has such a duty does not answer the question whether he may adopt a collective bargaining agreement without seeking the approval of the court.

We are compelled to reject the district judge's conclusion that a receiver is not an employer under the NLRA unless he becomes a "party" to the labor agreement, because that reasoning could lead to confusion if applied outside this limited area of agreement adoption. We believe, however, that he accurately considered the legal authorities relating to the power of receivers to assume executory agreements

and appropriately reconciled the demands of the bankruptcy and labor acts. We thus read the district court opinion as concluding only that a receiver is not a typical employer under the NLRA insofar as his 8(d) duty to bargain is limited by his lack of legal authority to affirm an executory labor agreement without the permission of the bankruptcy court. *Cf. Truck Drivers Local 807* v. *Bohack Corp., supra,* 541 F.2d at 320 (observing that the statement that the debtor is not a "party" cannot be taken literally since one not a party technically cannot affirm or reject an agreement).

We now address the issue whether the district court was correct in concluding that the receiver lacked authority to bind the debtor's estate by affirming the contract. We begin with the basic principles that the "order authorizing the receiver to operate the business does not, in itself, confer unlimited authority to operate the . . . [h]otel," *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 786 (quoting 8 Collier on Bankruptcy ¶ 6.35[8], pp. 961-65 (14th ed. 1976)), and that "[p]arties dealing with a receiver are charged with knowledge of the extent of any restrictions upon his authority." *Id.* (citing *In re Yellow Transit Freight Lines,* 207 F.2d 602, 606 (7th Cir. 1953)). As the receiver's order of appointment by the bankruptcy court does not appear to grant any unusual authority, the question here is essentially one of law and not of construction of the appointing order.

While neither we nor the Supreme Court has passed on the question before us, the more persuasive cases from other jurisdictions hold that " 'assumption or adoption of the contract can only be effectuated through an express order of the [bankruptcy] judge.' " *In re American National Trust,* 426 F.2d 1059, 1064 (7th Cir. 1970) (quoting 6 Collier on Bankruptcy ¶ 3.23[5], p. 578 (14th ed. 1976)). *See also Texas Importing Co.* v. *Banco Popular de Puerto Rico,* 360

F.2d 582, 584 (5th Cir. 1966). The basic reasoning for this view is expressed by Collier:

> The general rule that economy of administration calls for close, strict, and active control by the court of all administrative expenditure seems to lead to the conclusion that it is improper for a trustee to assume executory contracts on his own responsibility.

4A Collier on Bankruptcy ¶ 70.43[5], at 531 (14th ed. 1976). Similarly, we have expressed the view that "[i]t is well settled bankruptcy law that on important decisions, whatever their character, the trustee must get the court's approval. . . ." *Newport* v. *Sampsell,* 233 F.2d 944, 946 (9th Cir.), *cert. denied,* 352 U.S. 942 (1956).

Indeed, as the bankruptcy court is vested with exclusive jurisdiction over the property of the debtor, we believe its authority to allow rejection of burdensome contracts gives it a needed flexibility that should not be relinquished except by the court. Therefore, we agree with the Fifth Circuit that the Act should not be construed to grant the trustee or receiver authority to "bar the court from exercising its statutory power to authorize the rejection of such a contract. . . ." *Texas Importing Co.* v. *Banco Popular de Puerto Rico, supra,* 360 F.2d at 584. This concern for needed flexibility is particularly compelling as against the Union's contention that the receiver should be viewed as having affirmed the contract when he knowingly conforms to its terms. *See Pacific Western Oil Co.* v. *McDuffie,* 69 F.2d 208, 213 (9th Cir.), *cert. denied,* 293 U.S. 568 (1934) (recognizing the receiver's need to be able to conform to the terms of an existing contract experimentally while deciding whether the contract should be rejected or affirmed).

It should come as no surprise that there is conflicting authority on this issue since the power to assume executory contracts is not found in the Act, but rather is inferred from the bankruptcy court's power to approve rejection

of such agreements. 8 Collier on Bankruptcy, ¶ 315[6], at 204-05 (14th ed. 1976). Some courts have recognized a receiver's right to affirm executory contracts, relying upon precedent from pre-Bankruptcy Act reorganization under equity, in which receivers had that authority. *E.g., In re Public Ledger, Inc.,* 161 F.2d 762 (3d Cir. 1947). This practice, in turn, has been criticized on the ground that the Bankruptcy Act is intended to involve "a higher degree of judicial supervision and responsibility." 4A Collier on Bankruptcy, ¶ 70.43, at 531-32 n.30b. We are in accord with the latter view and agree with the district court that "[t]he assumption or rejection of executory agreements affects the outcome of the chapter proceeding and should proceed under the supervision of the court." *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 787.

The Union relies primarily on *In re Public Ledger, Inc., supra,* 161 F.2d 762, which held that a receiver or trustee has authority to assume a labor agreement without seeking the approval of the bankruptcy court and may do so by knowingly conforming to its terms. *Id.* at 767. The case involved an employee's claim for vacation pay that had accrued under a collective bargaining agreement entered into prior to the outset of bankruptcy proceedings. Trustees had paid wages according to the terms of the agreement, but the bankruptcy court denied claims for vacation pay on the ground that it had never approved assumption of the agreement. The Third Circuit stated that "[i]t is unreasonable to assume that the [bankruptcy] court contemplated anything but the continuance of the labor contract as the basis for the continued services of the employees." *Id.* In addition, the court focused on the equities involved, observing that "the claimant had worked for a year and was entitled to his vacation pay." *Id.* at 768.

It appears to us, however, that the court in *Public Ledger* could have ruled on a narrower ground[4] and did

not adequately consider the implications of granting authority to a receiver or trustee to adopt a long-term collective bargaining agreement. We have not found any cases holding that a receiver or trustee had authority to adopt a long-term collective bargaining agreement that actually bound the debtor's estate beyond the term of his trust, and, like the district court, we find the reasoning against such authority "even more persuasive if the assumption of an executory contract will bind the estate in the future rather than merely establish a priority as an administrative expense." *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 788. Since the equities of cases such as *Public Ledger* can be addressed without granting receivers authority to bind the debtor and without removing needed supervision power and flexibility from the bankruptcy court, we conclude that the receiver lacked authority to adopt the 1973-1977 labor agreement.[5] Consequently, the bankruptcy court retained power to authorize rejection of the agreement.[6]

IV

We address, finally, whether the bankruptcy court could void the new agreement extending and modifying the pre-bankruptcy contract between Hotel Circle and the Union. This issue turns on whether the receiver was authorized to enter into a long-term collective bargaining agreement.[7] Courts do not recognize contracts that exceed the limited authority of a receiver, *In re Avorn Dress Co.,* 79 F.2d 337 (2d Cir. 1935), and parties dealing with a receiver are charged with knowledge of his limited authority. *Id.*; *In re Yellow Transit Freight Lines, supra,* 207 F.2d at 606. Courts generally will not retroactively validate contracts which exceeded the authority of the receiver. *In re Avorn Dress Co., supra,* 79 F.2d 337; *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 790 & n.2.

The Union contends, however, that the receiver possessed authority to enter into the new contract. It argues that we should read the language of the receiver's order of appointment together with the receiver's duty to bargain under the labor laws to find that he had such authority. The order of appointment authorizes the receiver to "enter into any contracts incidental and usual to the operation of said business and the management and preservation of said property." The Union contends that a labor agreement is "incidental and usual" to the operation of a hotel, and it argues that receivers will be unable to secure the labor needed to operate the business if they are unable to enter into such agreements. In most respects, their arguments here parallel those discussed earlier in which they contended that receivers may unilaterally assume existing agreements. We reject these arguments for basically the same reasons.

We first examine the language of the order of appointment. The Union emphasizes that long-term collective bargaining agreements are typical in the hotel industry, suggesting that this makes them "incidental and usual." We believe that the phrase "incidental and usual" has a more restrictive meaning, and that it refers to contracts necessary to the daily operation of the business. As stated by the Supreme Court:

> It is undoubtedly true that a receiver, without the previous sanction of the court . . . may incur ordinary expenses or liability for supplies, material, or labor needed in the daily administration of . . . property committed to his care as an officer of the court; but it seems equally well settled that the courts decline to sanction the exercise of this discretion on the part of receivers in respect to large outlays, or contracts extending beyond the receivership, and intended to be binding upon the trust.

Chicago Deposit Vault Co. v. *McNulta, supra,* 153 U.S. at 561. *Cf. Newport* v. *Sampsell, supra,* 233 F.2d at 946 (it is settled that the trustee must get the court's approval on all important decisions).

We are not persuaded that the relevant case law justifies a different result in the case of long-term collective bargaining agreements. The most illustrative example of a court sanctioning a receiver or debtor-in-possession entering into a labor agreement is *In re Wil-Low Cafeterias, Inc.,* 111 F.2d 429 (2d Cir. 1940). In that case, much as in *In re Public Ledger, Inc.,* discussed earlier, employees sought to obtain accrued vacation pay that had been denied by the trustee on grounds that the debtor's post-bankruptcy contract was invalid as beyond the authority granted the debtor-in-possession by the bankruptcy court. We agree with the district judge that the court in *Wil-Low* recognized the agreement "for the purpose of awarding benefits accrued under the contract," *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 786, and we would apply the same analysis developed in our discussion of *In re Public Ledger, Inc.* Indeed, *Wil-Low* appears to acknowledge the limitation we are recognizing as the court specifically reserved the question whether the debtor-in-possession could have bound the estate in the future without permission of the court: "It may be that the court would have had the power to rescind such a contract so far as it remained unperformed, but no such thing was attempted." *In re Wil-Low Cafeterias, Inc., supra,* 111 F.2d at 431.

We conclude, therefore, that the district court was correct in deciding that "[t]he order authorizing the receiver to continue to operate the business of the debtor, did not grant the receiver the authority to enter into . . . the modified collective bargaining agreement. . . ." *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 791. This conclusion is unaffected by the re-

ceiver's status as an employer under the labor laws and his corresponding duty to bargain. The receiver is required to retain any grievance machinery to process employee disputes, and he is obligated to meet and confer with the employee bargaining representative as required by section 8(d). Nevertheless, his section 8(d) duties are limited to the extent that he cannot enter into a long-term collective bargaining agreement without obtaining the permission of the bankruptcy court.

It may at first glance seem harsh to allow the debtor relief from the contract entered into and relied upon by the Union. We have already observed, however, that parties dealing with an officer of the bankruptcy court are assumed to know the limits of his authority. In addition, it is not as though a union is without an option in such cases. Both with reference to adoption of an existing agreement as well as the negotiation of a new one, a union may insist upon obtaining the authorization of the bankruptcy court. *See Texas Importing Co.* v. *Banco Popular de Puerto Rico, supra,* 360 F.2d at 584-85; *Philadelphia Co.* v. *Dipple,* 312 U.S. 168, 174 (1941). Unions should be on notice that court approval is required if a long-term collective bargaining agreement, with potential for binding the estate beyond the term of receivership, is to be affirmed or validly entered into by the parties.

AFFIRMED.

FOOTNOTES

[1] The section provides:

> Upon the filing of a petition, the court may, . . .—
>
> (1) permit the rejection of executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate.

[2] In *Kevin Steel,* the court also addressed the argument, not presented to us, that businesses will enter bankruptcy proceedings to free themselves of labor agreements. *Shopmen's Local 455* v. *Kevin Steel, Inc., supra,* 519 F.2d at 705-06. Our decision does not reach the issue but leaves room for a later determination whether, when the debtor is in bad faith, the agreement is therefore not onerous or burdensome. *See In re Mamie Conti Gowns, Inc.,* 12 F. Supp. 478, 480 (S.D.N.Y. 1935).

We also do not need to address the question whether the bankruptcy court should apply a stricter standard for authorizing the rejection of collective bargaining agreements as a means of reconciling the policies of the labor and bankruptcy laws. *Compare Shopmen's Local 455* v. *Kevin Steel Products, Inc., supra,* 519 F.2d at 706-07, *with Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp., at 789.

[3] In some cases the bankruptcy court will not need to reach the rejection issue. For example, if an extension of an old contract or a new contract does not receive approval of the bankruptcy court, the new employer would not be bound by it, *e.g., NLRB* v. *Burns Int'l Security Services, Inc.,* 406 U.S. 272 (1972), and that might well be dispositive of the case. That determination would be based upon whether or not the remaining time of the old contract, here from 1975 to 1977, needs to be rejected in order to fulfill the purposes of the Bankruptcy Act. Under *Burns* and other cases, there may not be a need for the bankruptcy court to act any further as the new owner may be insulated under the successor employer doctrine. *E.g., id.* On the other hand, in some circumstances a new employer may have the responsibility to arbitrate over provisions in the old contract arguably intended to be given continuing effect. *See John Wiley & Sons, Inc.* v. *Livingston,* 376 U.S. 543, 552-55 (1964). Whether such concerns are present, and whether the bankruptcy court therefore reasonably believes that a rejection order is necessary as a concondition of the new employer purchasing the old company, must be determined on a case-by-case basis. Here we cannot say that the bankruptcy court was in error when it considered that there was a need to reject the remaining part of the whole contract.

[4] In *In re Schenectady Ry.,* 93 F. Supp. 67 (N.D.N.Y. 1950), for example, the court found that trustees in a Chapter X proceed-

ing were obligated to pay accrued pension benefits, but still concluded that the contract had not been assumed nor could be without court approval. Since the trustee's order of appointment authorized him to pay the operating expenses of the business, including wages, the court found that the trustee had adopted certain employee benefits, including pensions and vacation pay, as part of those wages when he used the labor contract "as a yardstick or measure of obligations" and knowingly conformed to the agreement's terms. *Id.* at 69. Although "equitable considerations" required that the pensions be paid as "a part of operating expense . . . during the period that the parties knowingly conform to the terms of the contract," *id.* at 70, the court still held that the trustee could not adopt the agreement because it "might seriously encumber the assets [of the debtor] without the consent and approval of the Court." *Id.* at 69. *See also In re Capital Service, Inc.*, 136 F. Supp. 430, 437 (S.D. Cal. 1955) (finding vacation pay to be an administration expense without reaching assumption question on ground that debtor "rehired the employees at the old rates of pay and under the old terms and conditions of employment"); 4A Collier on Bankruptcy ¶ 70.43[5], at 531 n.30b (14th ed. 1976).

[5] Thus, despite the Second Circuit's persuasive reasoning on the applicability of section 313(1) to labor agreements, we reject their additional conclusion that a receiver may assume an executory contract by conforming to its terms. *See Brotherhood of Railway, Airline and Steamship Clerks v. REA Express, Inc.*, 523 F.2d 164, 170 (2d Cir.), *cert. denied*, 423 U.S. 1017 (1975) (relying on *In re Public Ledger, Inc., supra*).

[6] Having concluded that the receiver lacked authority to affirm a long-term collective bargaining agreement, we need not address whether the district court erred in finding that the receiver did not manifest a clear intent to affirm the contract.

[7] Like the district court, we do not reach the question whether section 313(1), allowing rejection of executory contracts of "the debtor," applies to valid contracts of the receiver.